

## **Affinity Water: PR24 Business Plan Submission – Commentary**

Through the remainder of this AMP and AMP8 we will see the evolution and development of two separate markets: the first being connections to existing mains, and the second being larger developer customers requiring requisition mains. We foresee Affinity Water playing pivotal albeit different roles in each. Major changes include the discontinuation of incumbent provision of income offset, and the separation of site-specific work from the Network Plus price control.

The connections volume we are forecasting aligns with wider market and political expectations where, moving out of the mid-AMP7 lull, there is an increase in connections volumes moving through into AMP8. This works in conjunction with the need for network reinforcement to support the network and growing dependencies upon it.

We have seen a trending increase in self-lay providers undertaking a greater proportion of, predominantly, requisition mains and larger developer schemes. We expect this to continue into the next asset management period reaching a market share of c. 75% of schemes that move into construction within our region. This is in line with the performance of self-lay providers throughout the wider water market.

In conjunction with the increase in work being awarded to self-lay providers, there is also an increase in new appointment and variations applications, albeit a slightly slower rate whilst these companies establish themselves within our area of service and completing the connection process. We understand that, as the new appointment and variation market continues to mature, there will be an increase in partnerships formed with self-lay providers and forecast that they may become the main customer type we will serve by the end of AMP8.

We anticipate a steady requirement for diversion works across s185 and NRSWA types; this work remains within the Network Plus price control.

### **DS1e: Developer services revenue (English companies)**

#### **Summary**

We note that adherence to confirmed and proposed changes to the charging rules has been illustrated and built into the data table forecasts and therefore are reflected in the associated revenue. This includes the removal of incumbent provision of income offset and environmental incentives vs. environmental infrastructure component achieving a net-zero balance.

Whilst, at this time, confirmation of common environmental incentive structures are yet to be provided it is something we continue to develop alongside our bespoke offerings which will be aligned to our customer preferences. This includes further

investigation into the promotion and uptake of water neutral sites and how this may be more widely adopted.

It is assumed that the general charging principles will remain moving into the next asset management period as referenced in the recent Ofwat consultation on the charging approach for new connections. Our approach will continue to be that of improvement, innovation and delivering a service that our customers want.

Revenue received from customers includes an element of funding for continuous improvement delivery. This ensures developer customers fund advancements relevant to their experience and needs in the developer services arena. Our charges align to the five charging principles, they are and will continue to be fair, stable and cost reflective of works being undertaken to deliver works and departmental service improvements.

#### DS1e.1-3: Diversions revenue

It is assumed that all diversions revenue will remain consistent across all future years. We understand diversion work may ultimately see fluctuations as a result of changes in government policy and influenced by local council targets. This makes it challenging to predict and therefore historic trends have been used to guide the anticipated revenue forecasts. We note that we do not expect other non-section 185 diversions to generate revenue over the next asset management period. It is assumed, that although there may soon be national spending reviews on the delivery of larger construction projects as a result of a change in elected government, these may not immediately impact the revenue associated to NRSWA and Section 185 diversions.

#### DS1e.4: Infrastructure charge receipts

We have assumed the infrastructure charge receipts are linked to the number of connections estimated in DS4 and thus are reflective of the rate of growth we predict to occur in 2025 – 2030. However, we note that the values are not directly aligned to the expenditure illustrated in DS2e.

The discrepancy between infrastructure revenue and expenditure is assumed to be a result of numerous factors including the confirmed changes to the charging rules which introduce an elevated risk of infrastructure debt. This heightened risk stems from the substantial shift in net position of infrastructure and income offset. We have assumed certain scheme types will continue to utilise fixed netted quotes, leading to a misalignment between construction and payment years, further contributing to the disparity.

We have also assumed infrastructure schemes have a higher likelihood of spanning multiple construction years, thus incurring greater costs. Extended timelines, for both infrastructure projects and new connections schemes, not exclusively those assumed to be 'large', risk bridging multiple financial years. This, in turn, can lead to a reduced recovery of infrastructure costs due to existing agreements. We have introduced some mitigation clauses to our charging arrangements which aim to reduce the impact on revenue recovery.

We note that the current infrastructure recovery approach has led to some challenges through 2020 – 2025 which impacts our illustrated forecasts as a result of current disparity between revenue and expenditure. The imbalance in relevant costs incurred to deliver infrastructure reinforcement amplifies the challenge of aligning revenue and expenditure.

#### DS1e.5: Other developer services revenue (price control)

It is assumed that, in line with historic performance, there will be no additional developer services revenue within the price control.

#### DS1e.7: Income offset associated with legacy agreements

The table reflects the decision for incumbents to remove the provision of income offset from the beginning of the 2025 charging year, following changes to the charging rules. Throughout customer consultation in advance of the 2024-25 charging period we will be looking to explore how we may best deliver a solution to the dissolution of income offset. Our current approach, although supported by customers may result in a small volume of connection-only schemes that would still qualify for income offset in the 2025-26 period, resulting from quote validity and the transition period.

#### DS1e.8-9: Environmental Incentives and infrastructure charge components

It is assumed customer support and acceptance continues for our proposed approach to gradually phase out income offset alongside the increase in offered environmental incentives through to the end of 2024-25 charging. All 2025 – 2030 environmental incentives and counter-infrastructure charge components have been assumed to achieve a net-zero balance as per consultation earlier this year. Affinity Water are keen to innovate and advocate for increased water neutrality initiatives and aim to build upon our breakthrough challenge Water Neutrality on new appointment and variations sites project, funded by Ofwat.

#### DS1e.13: Other Developer Service Revenue (Non-Price Control)

In line with other associated business plan documents, we are actively exploring and developing new sources of revenue beyond the regulated price control. Our efforts and focus on diversification highlight a strategic effort to enhance our financial sustainability. Whilst we are making every effort to develop our supportive offering to the open market, the data lines remain static illustrating no additional non-price control revenue until developments become more robust.

#### DS1e.16-29: Developer services revenue – wastewater network+

This block is intentionally blank as it's not relevant to Affinity Water.

## DS1w: Developer services revenue (Welsh companies)

This table is intentionally unpopulated as it's not relevant to Affinity Water.

## DS2e: Developer services expenditure - water (English companies)

### Summary

The expenditure for this table is intrinsically linked to the forecast of new connections as illustrated in DS4. By doing so, we are confident the values are representative of expected work volumes, proportional spread and in line with growth forecasts and market fluctuations.

Ensuring the unit costs are reflective of contractual rate changes and other requirements to deliver such works, (whether that be self-lay, or incumbent connections with or without an associated new main) allows the tables to remain in line with core charging principles of transparency, fairness and capturing the relevant cost of service(s).

The inclusion of developer-funded continuous improvement as an element in our charges build up ensures we capture expenditure in line with this on a per connection basis. This ensures developer customers fund advancements relevant to their experience and needs in the developer services arena. Expenditure year on year will remain in line with revenue collected against the volume of plots to deliver a balanced position.

At this time we do not anticipate significant changes in expenditure to deliver new connections and therefore forecast stable developer services costs.

### DS2e.1: Infrastructure network reinforcement

We have assumed the infrastructure network reinforcement expenditure is linked to the number of connections estimated in DS4 and thus are relative to the rate of growth we predict for 2025 – 2030. However, we note that the values are not directly aligned to the receipt revenue illustrated in DS1e.

The discrepancy between infrastructure revenue and expenditure is assumed to be a result of numerous factors including the confirmed changes to the charging rules which introduce an elevated risk of infrastructure debt. This heightened risk stems from the substantial shift in net position of infrastructure and income offset. We have assumed certain scheme types will continue to utilise fixed netted quotes, leading to a misalignment between construction and payment years, further contributing to the disparity.

We have also assumed infrastructure schemes have a higher likelihood of spanning multiple construction years, thus incurring greater costs. Extended timelines, for both infrastructure projects and new connections schemes, not exclusively those assumed to be 'large', risk bridging multiple financial years. This, in turn, can lead to a reduced recovery of infrastructure costs due to existing agreements. We have introduced some mitigation clauses to our charging arrangements which aim to reduce the impact on revenue recovery.

We note that the current infrastructure recovery approach has led to some challenges through 2020 – 2025 which impacts our illustrated forecasts as a result of current disparity between revenue and expenditure. The imbalance in relevant costs incurred to deliver infrastructure reinforcement amplifies the challenge of aligning revenue and expenditure.

#### DS2e.2: Asset payments associated with legacy agreements

It is assumed that all outstanding payments related to legacy assets will be fully settled by the conclusion of the 2024-25 charging year.

#### DS2e.3: New connections

There is a shift in our allocation of new connections revenue in 2023-24 which sees it move from Opex to Capex. The applied methodology and forecasted calculations remain the same and are not expected to be impacted as a result of this approach.

#### DS2e.4: Other site-specific developer services activities

We understand there are variances in applied unit costs for connections which may or may not require new mains or are undertaken by self-lay; these have been reflected in the data to ensure traffic management, surveying, meter costs and other additional contractual deliverables are appropriately captured.

#### DS2e.3 & DS2e.5–7: Non-price control; Site-specific costs for developments

We understand there are variances in applied unit costs for connections which may or may not require new mains or are undertaken by self-lay; these have been reflected in the data to ensure traffic management, surveying, meter costs and other additional contractual deliverables are appropriately captured.

#### DS2e.7: Other site-specific developer services activities

It is assumed that the expenditure against this line is inclusive of self-lay connection meters. The unit costs underpinning this data line are aligned to contractual agreements as procured at the conclusion of the tender process and are not solely determined by deflated costs as per the 2022 November CPIh rate.

## DS2w: Developer services expenditure - water (Welsh companies)

This table is intentionally unpopulated as it's not relevant to Affinity Water.

## DS3: Developer services expenditure – wastewater (English and Welsh companies)

This table is intentionally unpopulated as it's not relevant to Affinity Water.

## DS4: Developer services non-financial data

### Growth

Growth forecasting has been greatly impacted by the recent national financial volatility. We saw a decline in growth during mid-AMP7, in part, due to the increases in Bank of England interest rates, the cost-of-living crisis, higher mortgage rates and lack of affordable homes. With anticipated changes to the political landscape, resulting from the general election before the end of AMP7, we remain adaptable to possible growth rate fluctuations.

We continue to develop our growth data set and align with forecasts suggesting the avoidance of a recession and growth recovery to start at the beginning of AMP8. We anticipate slow but steady growth in connection rates moving through years one and two of AMP8 with increased acceleration through the latter half of the AMP.

We will build and expand on our AMP7 work to aid more significantly in the self-lay design work arena, to network sustainability, longevity and, ultimately, customer protection. Although currently there are no finalised self-lay design work agreements, we are working to secure additional non-regulated commercial revenue via this avenue. We are in discussions with multiple self-lay providers to establish anticipated workload and viable Affinity Water offering.

We note there is consistent disparity across the APR 4R and 4Q tables, which is clear through all publications during the 2020 – 2025 period. While we have, where deemed sensible and coherent, diligently aligned the PR24 tables with these metrics as required by the guidance, it is important to acknowledge that this misalignment has repercussions on values that may otherwise expected to coincide. We have selected to align SUP1B.1 and .2 (residential and business properties connected in year) to the growth scenario outlined in DS4 for years 2023-24 onwards and thus APR Table 4Q; we have maintained alignment of the APR Table 4R association for 2022-23. By doing so, we understand there is a small shift in properties between the years but feel assured this approach to forecasting properties connected in year aligns to our new connection growth strategy.

The variance in these figures is a result of the construction of a number of illegal connections and the scheduling of meter data processing. Additionally, delays in incorporating meter data into the billing system and the extended time taken for data retrieval from self-lay providers through the process exacerbate this inconsistency. We recognise this and continue to operate with it in mind. As we strive for transparency and accuracy, we believe it's essential to highlight such nuances for a clearer understanding.

### Market Shift

As the self-lay provider market grows and a greater proportion of requisition mains and associated connections are constructed by such delivery competitors, we have forecasted a reduction in mains laid by Affinity Water. However, we acknowledge not all schemes that require new mains will fit within the parameters currently

outlined by Ofwat and as such we applied a cap of 95%, to mains length to be laid by self-lay providers, to ensure this was adequately reflected and retained by Affinity Water.

Alongside the increase in self-lay providers, there is an increase in new appointment and variations (NAV), potential NAV sites and, the opportunity for partnerships to be formed between the two key market players. Since 2021, properties connected by NAVs has increased by 40%, to approximately 8% of the total connected properties. We forecast this percentage will increase to 12% by the end of AMP8 as the new regulatory approach to developer services comes into play.

There is additional work to be undertaken to review the prospective NAV list which continues to grow in advance of AMP8. Although there is movement in the establishment of more NAV sites within our region, we are yet to see this be materially illustrated in accelerated NAV schemes moving to construction, being completed and become fully established.

#### DS4.1-3: New connections – excluding NAVs

These numbers were driven by our property forecast and reflected the latest connections methodology produced by OFWAT for the 2022-23 APR data returns.

#### DS4.4: New connections – SLPs

We forecasted a continuation of growth in the SLP connections market. To ensure our numbers replicated this, we forecasted a positive percentage of connections using APR 2020-21, 2021-22 & 2022-23, then applied the percentage to the connection numbers (see DS4.1-4.3)

#### DS4.5-7: New properties - excluding NAVs

As per the guidance we used the APR numbers to help us forecast property numbers. We didn't think this fully reflected the challenges we are facing due with the current economic position and supply challenges. The APR data only covered the last 3 years that has seen its own challenges. We have used learning from the 2008 challenges to help us guide our property numbers.

#### DS4.8-10: New properties served by NAVs

NAV are becoming a key player in delivering housing and we believe this trend will continue through to 2030. The total percentage of our properties delivered by NAVs has been less than 10% in the last 3 years. We believe this will steadily trend upwards but have forecasted this to be a steady growth in part due to the challenges discussed earlier with housing but also understanding this emerging market still has a relatively small number of suppliers.

#### DS4.11: Total new properties

This is a simple sum based on assumptions above (DS4.7 & DS4.10)

#### DS4.12: New properties – SLP connections

In line with our approach to SLP connections (DS4.4) we used historic % of properties delivered by SLP to forecast. This helped support the growth in this market but also aligned it to market conditions.

### DS4.13 - 14: Length of new mains (km)

We have seen significant increase in mains delivered by SLP since 2020. We forecast this to continue through to 2030. The numbers are based on average length of pipe per property and then associated with market share we anticipated to be delivered.

## DS5: Network reinforcement costs

### Reinforcement

We currently have plans to maintain a steady rate of infrastructure charge receipts, although connections rates are shown to increase over AMP8, we must account for legacy schemes, scheme delivery duration and scheme closure processing. In general, we aim to limit the impact of infrastructure charge increases on our customers, in line with the charging rules, whilst maintaining appropriate reinforcement and connection forecasts and therefore have taken the approach that the infrastructure charge will remain relatively static through AMP8.

As growth continues to be realised, it becomes more challenging to ensure our network is able to suitably supply the required provision of water for new developments and connections. We see this reflected in the increased costs of network reinforcement outlined in DS5. Network reinforcement values, as per the DS5 table, are subject to further work which will aim to clarify the price base for provided values, and clarity on scheme selection, likelihood and urgency. This will be completed in conjunction with the Asset Strategy and Capital Delivery team.

The Southeast region of England has seen an increase of c.40% in planning applications, which has contributed to the increasing network reinforcement costs outlined in DS5. A proportion of these sites are anticipated to be require site specific network reinforcement and therefore will not be funded by the infrastructure charges contributed by developer customers.

We understand the currently illustrated approach to steadied infrastructure charges contributes to the high-risk growth impacts if the market sees significant shifts in either direction. Unlike in AMP7 with the Developer Services Recovery Adjustment mechanism (DSRA), there is no revenue recovery mechanism outlined in AMP8 and without such there is additional risk against incumbents where external and geopolitical factors result in considerable network reinforcement requirements. The reinforcement landscape requires developer services to continue to be agile and adaptable.

### DS5.1 – 5.2: Distribution and trunk mains

It is assumed these costs continue in line with the volume of properties we forecasted to connect in table DS4. We do not believe there will any impact to reinforcement requirements or costs with the continued growth in SLP and NAV market.

### DS5.3: Other

We have continued to assume there will be no cost associated here.



#### DS5.4: Total

This is a sum of the above.

#### DS5.5-9: Wholesale wastewater network+ (sewage collection)

This block is intentionally blank as it's not relevant to Affinity Water

## DS6: Network reinforcement drivers – potable mains, sewers, pumping stations and pumping capacity

### Investment

For consistency of approach, we have aligned the data in DS6 with the forecasted rate of growth anticipated in DS4. These figures, as explained in our commentary, identify several factors that are likely to impact the housing market and in turn the overall impact to length of mains needed. As a company we are maturing in the way we utilise information to help support improved collaboration between different parts of our business and the different drivers we have.

### Emerging Markets

During AMP8, we anticipate significant growth in the self-lay and NAV (New Appointments and Variations) market segments. It's important to note that self-lay work falls under the category of 'onsite' contestable work, and as such, we do not expect this expansion to exert any influence on the factors driving reinforcement. Similarly, the heightened activity in the NAV market is not expected to have any impact on these drivers, mirroring our expectations for the self-lay sector.

### Future

As an ambitious company working toward water neutral development through OFWAT funded projects and our approach to environmental incentives, we understand the impacts could have long term on the need for reinforcement. We do not have data yet to support the impact this could have and currently, do not until after AMP8.

#### DS6.1 & 6.3: Length of new potable - proportional allocation

We have not proportionally allocated any of our mains

#### DS6.2: Length of new potable mains laid - full allocation

We replicated the requisitions lengths in line with DS4.13&4.14. Other lengths have been forecasted based on data request submission to OFWAT with APR property numbers for unit rate. Then forecasted based on DS4.11 properties.

#### DS6.4: Length of potable mains upsized - full allocation

We have not forecasted any upsizing.

#### DS6.5-8: Sewers

This block is intentionally blank as it's not relevant to Affinity Water

**DS6.9, DS6.11 & DS6.13: - proportional allocation**

We have not allocated any proportional allocation.

**DS6.10, DS6.12 & DS6.14: full allocation**

For consistency, we have applied the same approach using the data provided to Ofwat for their information request against APR properties for unit rate and applied against forecasted properties.

**DS6.15-20: Pumping stations and capacity (wastewater)**

This block is intentionally blank as it's not relevant to Affinity Water.